UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

Louis Dreyfus Energy Services, L.P. Docket No. RP06-187-000

ORDER ON WAIVERS

(Issued March 3, 2006)

1. On January 26, 2006, Louis Dreyfus Energy Services, L.P. (LDES) filed a request for waivers to permit it to undertake a transaction involving a capacity release above the maximum rate cap and a long term firm natural gas sale and purchase agreement. LDES specifically requests: (i) a waiver of the maximum rate ceiling generally applicable to releases of interstate pipeline capacity, (ii) a waiver of the Order No. 636-A policy limiting the "tying" of gas purchase and sale arrangements to released capacity,[1] and (iii) any other waivers that the Commission may deem necessary. As discussed below, the Commission denies the requested waivers.

Details of the Instant Filing

2. LDES states that in 2005 it acquired transportation capacity from Trunkline Gas Company, LLC. (Trunkline) under two long-term maximum rate firm transportation service agreements which allow LDES to transport gas from Texas markets to Louisiana markets.

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[1] Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 636, 57 Fed. Reg. 13,267 (April 16, 1992), FERC Stats. and Regs., Regulations Preambles (January 1991 - June 1996) ¶ 30,939 at 30,446-48 (April 8, 1992); *order on reh'g*, Order No. 636-A, 57 Fed. Reg. 36,128 (August 12, 1992), FERC Stats. and Regs., Regulations Preambles (January 1991 - June 1996) ¶ 30,950 (August 3, 1992), *order on reh'g*, Order No. 636-B, 57 Fed. Reg. 57,911 (December 8, 1992), 61 FERC ¶ 61,272 (1992), *order on reh'g*, 62 FERC ¶ 61,007 (1993), *aff'd in part and remanded in part, United Distribution Companies v. FERC,* 88 F.3d 1105 (D.C. Cir. 1996), *order on remand*, Order No. 636-C, 78 FERC ¶ 61,186 (1997).

3. LDES asserts that at the time it entered into these agreements, it was at risk for the demand charges, and that it had no material hedges in place to protect it against adverse movements in the value of gas delivered in Texas and the value of gas delivered in Louisiana (Texas-Louisiana basis). LDES states that as it began to execute gas purchase and sales transactions to hedge the value of its newly-acquired capacity, the Texas-Louisiana basis differential[2] began to widen to a much greater degree than anticipated, at least in part due to Hurricane Katrina. LDES states that with this increasing basis differential and gas commodity market volatility, it has become imperative for LDES to put on new, additional, hedges designed to protect it from further movements in the Texas-Louisiana basis differential and gas commodity markets.

4. LDES explains that under current generally accepted accounting principles in the U.S. (GAAP), the value of gas transportation contracts can not be marked-to-market (*i.e.*, carried on its books at the current fair value). However, LDES asserts that GAAP requires that natural gas purchase and sales contracts, and associated hedge transactions, be continually marked-to-market. Therefore, LDES asserts that because of its existing hedges, it is required under GAAP to adjust the value of the natural gas positions on its books but it may not correspondingly adjust the changes in the value of its transportation capacity on Trunkline.

5. Therefore, LDES asserts that, as a result of the widening of the Texas-Louisiana basis differential over the nine months since it acquired its long-term Trunkline firm service agreements, LDES had to record GAAP losses. LDES states that these losses represent over 70 percent of the book equity of LDES and more than 15 percent of the current book equity of its parent, Louis Dreyfus Corporation. LDES states that realization of these losses may cause LDES to show a significant loss for the year which would put LDES and its parent at a significant credit disadvantage, since credit rating agencies and trading counterparties focus on audited (GAAP) financial results.[3] LDES

[2] This basis differential refers to the difference between gas commodity prices at different points. Gas commodity price indices reflect gas prices at different points, such as at gas basins or certain receipt and delivery points and citygates. In brief, the difference in price between two points, as shown by the respective price indices, reflects the market value of transportation between the two points.

[3] LDES refers to these losses as "phantom" losses. However, these profits or losses are actual, accrued, losses and profits required by GAAP to show the financial position of LDES with respect to the subject financial instruments at a given point.

states that this will restrict its energy merchant activities and may render it difficult or impossible to enter into any further commitments for long-term firm gas transportation capacity.

6. LDES states that to avoid the accounting penalty described above, it proposes to execute a prearranged capacity release deal for the remaining term of LDES's contracts with Trunkline, under which the Buyer would assume the obligation to pay the maximum reservation rates for all of the Trunkline capacity held by LDES, plus the applicable usage rates. LDES states that, under the Commission's regulations, the release would be a "temporary," rather than "permanent," release, because LDES would (1) remain secondarily liable for the reservation charges, (2) retain certain recall rights, and (3) retain its right of first refusal for the purpose of extending the contracts at the end of their terms. In addition to paying the maximum reservation charges to Trunkline, the Buyer would also pay to LDES a lump sum reflecting the value of the Texas-Louisiana basis differential, less transportation costs.

7. LDES states that concurrently with this temporary capacity release, LDES and Buyer would execute a long-term firm gas purchase and sale agreement under which LDES would sell gas to Buyer in quantities and over a term corresponding to the MDQs and primary terms of the Trunkline service agreements. The price for this gas would be the first-of-the-month index price reported for the delivery month in *Inside FERC*'s Gas Market Report for Transco Station 65, minus the Trunkline transportation charges and a discount equal to the Texas-Louisiana basis differential, determined as of a date certain.

8. LDES also states that, in addition, the Buyer may appoint LDES as its exclusive agent for the purpose of marketing to third parties the gas Buyer purchases and transports to Louisiana using its Trunkline transportation rights. LDES would retain a monthly administrative fee and a per-MMBtu marketing fee that would compensate LDES for its guarantee of a minimum sales price to Buyer.

9. LDES asserts that this transaction would allow it to realize, up front, the revenues it could expect to realize over the term of the Trunkline service agreements, through a bundled sale of gas delivered at the Trunkline Louisiana delivery points, and eliminate the accounting disadvantage it currently faces. Moreover, LDES states that the proposal would require limited credit support from LDES. In sum, LDES asserts that its proposed transaction will alleviate its GAAP accounting issues, while allowing it to continue to purchase and sell gas to hedge its long-term transportation capacity position. LDES states that these transactions would conform to the Commission's goals of encouraging long-term capacity transactions and would produce precisely the same commercial result as would be achievable by means of a long-term bundled sale of gas delivered in Louisiana, but for the credit constraints that preclude LDES from entering into such a substantial long-term transaction.

10. To implement its proposal, LDES requests several waivers of the Commission's regulations and polices. First, LDES requests that the Commission waive the maximum rate cap on capacity release in section 284.8 of the Commission's regulations to permit LDES the opportunity to gain the true value of its Trunkline transportation capacity. Second, LDES requests that the Commission waive its prohibition against the tying of released capacity to other items to include the gas purchase and sale contracts in its release. Third, LDES generally requests any other waiver the Commission might find necessary to implement its transaction. LDES asserts that the Commission has previously granted similar waivers in *Northwest Pipeline Corp. and Duke Energy Trading and Marketing,* 109 FERC ¶ 61,044 (2004) *(Northwest)* and *Tennessee Gas Pipeline Company,* 111 FERC ¶ 61,509 (2005) (*Tennessee).*

Public Notice, Interventions and Protests

11. Public notice of the instant filing was issued with interventions and protests due as provided in section 154.210 of the Commission's regulations (18 C.F.R. § 154.210 (2005)). Energy America LLC (Energy America) filed comments one day out of time. Pursuant to Rule 214 (18 C.F.R. § 385.214 (2005)), all timely filed motions to intervene and any motions to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt the proceeding or place additional burdens on existing parties.

12. Energy America states that the Commission's action on the instant filing may have industry-wide implications. Energy America submits that if the Commission grants LDES' request for a waiver of the maximum rate ceiling generally applicable to releases of interstate pipeline capacity and a waiver of Order No. 636-A, the Commission should provide a clear explanation of its basis for doing so. Furthermore, it states that the Commission should establish a generally available procedure for obtaining such waivers that other, similarly situated parties can use in the future.

Discussion

13. The Commission denies LDES's requests for waiver of its capacity release regulations and policies. For the reasons discussed below, the Commission finds that LDES's request does not fit within the narrow range of waivers the Commission has been willing to consider.

14. LDES's proposed release would require waiver of the prohibition on releases of capacity above the maximum applicable rate contained in section 284.8 of the Commission's regulations. Sections 284.8(c) through (e) of the Commission's regulations require that capacity offered for release at less than the maximum rate must be posted for bidding, and that the pipeline must allocate the capacity "to the person

offering the highest rate (not over the maximum rate)." Section 284.8(h) provides that prearranged capacity releases at the maximum rate need not be posted for bidding. Section 284.8(h)(i) also provides that prearranged releases of capacity may not exceed the maximum rate.

15. The Commission has held that any consideration paid by the releasing shipper to a prearranged replacement shipper must be taken into account in determining whether the prearranged release is at the maximum rate. For instance, where the replacement shipper agrees to pay the pipeline the maximum rate for the released capacity, but the releasing shipper agrees to make a payment to the replacement shipper, the release must be treated as a release at less than the maximum rate to which the posting and bidding requirements of sections 284.8(c) through (e) apply.[4] Similarly, in the instant case, where the replacement shipper must agree to take the released capacity at the maximum rate and pay a lump sum to the releasing shipper, the Commission finds that the release of capacity proposed by LDES would be at a price above the maximum rate.

16. The Commission sees no basis for waiving the maximum rate ceiling in this case. In a few cases, the Commission has waived the maximum rate ceiling for capacity releases. However, that was for the purpose of permitting a shipper to exit the natural gas business[5] or permanently exit a service.[6] In those proceedings, the Commission granted a waiver to allow the releasing shipper to release capacity on a permanent basis utilizing the contract rate that it was currently paying, even if the rates exceeded the maximum applicable tariff rate. This was necessary for the permanent release to take place, since the pipeline would not agree to the permanent release if the replacement shipper did not

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[4] *See, Pacific Gas Transmission Co. and Southern California Edison Co*., 82 FERC ¶ 61,227 (1998).

[5] *See, Duke Energy Marketing America, LLC*, 114 FERC ¶ 61,198 (2006).

[6] *Tennessee Gas Pipeline Co*., 113 FERC ¶ 61,106 (2005). The shipper in this proceeding held a negotiated rate contract with Tennessee that it obtained when it converted from incremental Rate Schedule NET-284 service to a higher quality Part 284 Service under Rate Schedule FT-A. In order to take service under Rate Schedule FT-A, and still fully compensate Tennessee for NET expansion costs, the shipper paid a negotiated rate higher than the Rate Schedule FT-A maximum rate. When the shipper determined that it no longer needed Rate Schedule FT-A service, the Commission, given the unique circumstances of the subject capacity and rate, permitted the shipper to permanently release its Rate Schedule FT-A capacity, pursuant to a reverse auction, based upon the negotiated rate it was then paying for such service.

pay the same rate that the releasing shipper paid. Moreover, the waivers the Commission has granted have been limited to permitting the releasing shipper to release at a rate up to the rate it was paying the pipeline; the Commission has not permitted the releasing shipper to profit from release of capacity by allowing it to release capacity at a rate higher than the rate it was paying the pipeline.[7]

17. Here, LDES is not seeking to permanently release all of its rights to its Trunkline capacity as part of an effort to exit the gas merchant business. In fact, it expressly states that, while the release would be for the remaining term of the Trunkline contracts, the release would be a temporary release. Thus, LDES would continue to have contracts with Trunkline and, at the end of the current terms of those contracts, it would have a right of first refusal to continue those contracts. In addition, LDES is seeking a waiver for the purpose of enabling it to release at a rate higher than the rate it is paying to Trunkline.

18. LDES entered into its Trunkline capacity agreement, gas sales agreements, and subsequent hedging arrangements under the current GAAP accounting rules and Commission capacity release regulations. In so doing, it undertook a general business risk in order to take advantage of a perceived opportunity associated with gas commodity basis differentials between Texas and Louisiana. Neither the accounting rules nor the Commission's regulations have changed since LDES entered into its transaction. The only change since LDES entered into the transactions is that there has been more movement in the subject basis differential than LDES expected. Therefore, the transaction presented in the instant case appears designed to extricate LDES from a common business transaction with profit and credit intact, rather than designed to allow a company to exit the natural gas business in a rational and orderly fashion. The Commission will not grant a waiver for this purpose.

19. For the same reasons, the Commission denies waiver of its "tying" prohibition, which holds that a releasing shipper cannot tie the release of its capacity to any extraneous conditions.[8] LDES states that the Commission's tying prohibition has been

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[7] In the *Northwest* and *Tennessee* cases relied on by LDES to support its instant request, the releasing shippers did not request that the Commission permit them to release their capacity for more than the maximum rate and the Commission did not address the issue.

[8] The Commission articulated this prohibition against the tying of capacity in Order No. 636-A, where it stated that:

> Releasing shippers may include in their offers to release capacity

(continued)

explained as prohibiting an arrangement whereby a releasing shipper requires a replacement shipper to acquire relatively worthless capacity in connection with a release of more valuable capacity.[9] LDES states that in the instant case, Buyers will all wish to obtain both a long term gas supply and a means of transporting the supply to a liquid point in Louisiana and therefore there is no impermissible tying arrangement. Nevertheless, LDES requests a waiver of this prohibition to the extent the Commission determines necessary.

20. The Commission finds that LDES proposes to tie its gas sales contracts to its release of capacity. While shippers may place some value on the sales contracts, this is not the sole consideration in determining whether the Commission's prohibition against tying arrangements has been breached. In Order No. 636-A, in response to concerns that releasing shippers might attempt to add terms and conditions which tied the release of capacity to other compensation paid to the releasing shipper, such as an LDC requiring the potential replacement shipper to pay a certain price for local gas transportation service or a producer conditioning the release of capacity on the purchase of the producer's gas, the Commission added the language quoted above which states that "all terms and conditions for capacity release must be posted and nondiscriminatory, and

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> reasonable and non-discriminatory terms and conditions to accommodate individual release situations, including provisions for evaluating bids. All such terms and conditions applicable to the release must be posted on the pipeline's electronic bulletin board and must be objectively stated, applicable to all potential bidders, and non-discriminatory. For example, the terms and conditions could not favor one set of buyers, such as end users of an LDC, or grant price preferences or credits to certain buyers. The pipeline's tariff also must require that all terms and conditions included in offers to release capacity be objectively stated, applicable to all potential bidders, and non-discriminatory. Order No. 636-A at 30,557
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> The Commission reiterates that all terms and conditions for capacity release must be posted and nondiscriminatory, and must relate solely to the details of acquiring transportation on the interstate pipelines. Release of pipeline capacity cannot be tied to any other conditions. Order No. 636-A at 30,559.

[9] Transmittal letter at 14, *citing, Transwestern Pipeline Co.*, 92 FERC ¶ 61,035 (2000) (*Transwestern)*

must relate solely to the details of acquiring transportation on the interstate pipelines. Release of pipeline capacity cannot be tied to any other conditions."[10] Moreover, the Commission stated that it would not tolerate deals undertaken to avoid the notice requirements of the regulations. Therefore, although LDES cites *Transwestern* for the proposition that tying of capacity may only occur if an entity attempts to tie valuable capacity to relatively worthless capacity, it is clear from a reading of the Commission's statements in Order No. 636-A, that the prohibition is far broader than that interpretation and that the Commission's statements in *Transwestern* concerned only the type of tying arrangement alleged in that proceeding.

21. The Commission permitted the shippers in *Northwest* and *Tennessee* to combine capacity and sales agreements into a single package when the shipper proposed to effectuate a permanent release of capacity and its gas sales contracts to a prearranged shipper to permanently exit the gas business. The Commission concluded that since the releasing shipper in these proceedings was attempting to exit the gas transportation business, it should, within certain limitations, be permitted to exit in a rational and orderly fashion, if such action is open and will not unduly discriminate against other shippers.[11] Therefore, the waivers of the tying prohibition granted in *Northwest* and *Tennessee* were clearly predicated on the unique circumstance presented by a shipper attempting to exit the natural gas business in a rational and orderly fashion.

22. LDES argues that its situation is also unique because it could not have foreseen the unprecedented widening of the Texas-Louisiana basis differential, due in part to a hurricane, and points out that the circumstances are not likely to reoccur. However, LDES does not state that it intends to exit that natural gas business, as was the case in *Northwest* and *Tennessee*. LDES proposes a temporary release of capacity and states that it intends to recoup, up front, all of the revenues it could expect to realize over the term of the Trunkline service agreements through a bundled sale of gas, so that it would not be precluded from entering into other long term arrangements.

23. The Commission finds that in the instant proceeding, LDES has not shown good cause which would warrant the waiver of the Commission's regulations or policies concerning the release of capacity. Accordingly, the Commission denies waiver of its regulations and policies.

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[10] Order No. 636-A at 30,559.

[11] *Northwest* at P30.

The Commission orders:

The requested waivers are denied as discussed in the body of this order.

By the Commission. Commissioner Brownell concurring with a separate statement attached.

(S E A L)

Magalie R. Salas,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Louis Dreyfus Energy Services, L.P. Docket No. RP06-187-000

(Issued March 3, 2006)

BROWNELL, Commissioner, concurring:

This case raises a policy issue that I have, for some time, wanted to revisit. In Order 637, the Commission removed the rate ceiling for short-term capacity release transactions for an experimental two-year period ending September 30, 2002. The goal of the experiment was to increase flexibility and competition in the natural gas industry by adding greater efficiency to the secondary market. The data gathered during the experiment indicated some positive results.

Above Cap Releases accounted for up to 6 percent of the released volumes in any particular month with the highest volumes occurring during peak periods. Based on this information, the removal of the rate cap in the capacity release market did increase available peak capacity and facilitate the movement of capacity into the hands of those that value it most highly. Further, Above Cap Releases accounted for only 2 percent of the total number of capacity releases and 2 percent of the total capacity release gas volumes. This information illustrates an uncapped capacity release market that is competitive, resulting in just and reasonable rates for customers. Finally, of the thirty-four pipelines, seventy-six percent of Above Cap Releases occurred on four pipelines. This information is an important economic indicator of capacity need because, without the rate cap waiver, this capacity would have likely been sold in the "grey" market. Transparency in capacity pricing will facilitate infrastructure development and supply portfolio management.

I believe it is time to again consider enhancement to the secondary market in a generic proceeding.

For these reasons, I concur with today's order.

Nora Mead Brownell
Commissioner